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C O N F I D E N T I A L SECTION 01 OF 02 TOKYO 003311

SENSITIVE
SIPDIS

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SUBJECT: ECONOMIC CONFIDENCE AMONG JAPANESE SMES AND LARGE
MANUFACTURERS DROPPING RAPIDLY

Classified By: Ambassador J. Thomas Schieffer for reasons 1.5 (b) and (d).

11. (SBU) SUMMARY. Japanese large manufacturers and small and medium-sized enterprises (SMEs) are rapidly losing confidence in the economy. Large-scale manufacturers' business sentiment, according to one source, fell to its lowest level since 2002, while SME sentiment fell to its lowest level since 1998. Compounding Japan's falling business outlook are the negative numbers from the retail sector, which reported its steepest sales drop in 15 years. These preliminary figures suggest Japan's economy could be entering a steeper economic downturn than government forecasts had suggested, something exemplified by the transportation sector's extreme pessimism and data suggesting SMEs technically entered a recessionary business climate in July 2007. The official bank of Japan "Tankan" numbers, which will be released mid-December, should confirm the increasingly gloomy economic prospects. END SUMMARY.

LARGE MANUFACTURERS' BUSINESS CONFIDENCE COLLAPSES

12. (SBU) Japanese large manufacturers' business confidence collapsed based on a November economic research report. The 400 companies surveyed forecast their business activity will further decline, and thus Japan's economic conditions are likely to worsen over the next few quarters. The pessimism was greatest in the auto and auto parts sector where the sentiment index fell to -75, down 53 points. The overall decline brought business confidence for large manufacturers to its lowest level since May 2002. Business pessimism is reflected in the 27.3% fall in domestic Japanese auto sales for the month of November and Mitsui OSK's statement that trans-Pacific and European shipping volumes began falling in July 2007. According to Ministry of Economy, Trade and Industry (METI) officials, the drop in demand in the auto sector is unprecedented. Moreover, METI does not foresee an end to the drop and the GOJ and the auto sector are seemingly at a loss on how to respond.

SME BUSINESS CONFIDENCE CONTINUES ITS FALL

13. (SBU) Japan's small and medium-sized enterprises (SMEs), according to the Tokyo Chamber of Commerce and Industry (TCCI), entered a contractionary period as early as June 12007. SME business sentiment dropped steadily from -6 in June 2007 to -44 in the October 2008 TCCI business confidence survey. TCCI officials add the drop in SME business

confidence is nation-wide and that the impact of declining business activity is felt more strongly outside the Kanto region. The officials add that no SME sector is spared, with service, manufacturing, sales, export oriented and construction firms all feeling the negative impacts of a slowing global economy.

CONSUMERS GROWING MORE PESSIMISTIC AS HOLIDAYS APPROACH

¶4. (SBU) Large, medium, and small enterprises see consumers cutting consumption, which contributes to their declining sentiment. The Japanese Department Store Association's nation-wide sales data fell 6.8% in October, its steepest fall in more than 15 years, and Japanese consumer sentiment dropped to its lowest levels since the GOJ began keeping the survey in 1982. Department stores in Japan are already taking measures to prop-up sales, but only UniQlo, a discount clothing retailer, is expecting good year-end sales (28% in November). Japanese clothing (-6.8%), computer (-5%), household appliance (-5%) and audio visual (-9%) retailers all experienced steep sales declines in November and are not optimistic about December and January sales -- a period that accounts for nearly one-quarter of annual sales.

¶5. (C) Comment: Japan's economy is officially in a recession for the first time since 2001. Real GDP contracted 0.4% in the third quarter and the potential for positive GDP growth in early 2009 is not good given that consumer spending and exports are both in decline. Japan's political stalemate and its inability to enact economic and fiscal stimulus measures,

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even though the LDP proposed 10 trillion yen in new spending December 4, is not reassuring the business community or Japanese consumers. The worsening economic conditions are reflected in the falling support for the Aso Administration. According to a Nikkei poll of December 1, support for the current government stands at just 31%, down 17 points from October as a result of numerous factors, including policy (economic) miscues. End Comment.
SCHIEFFER